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February 18, 2005

VIA ELECTRONIC FILING

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington D.C. 20554

RE: Ex Parte Presentation; CC Docket No. 96-45

Dear Ms. Dortch:

On Thursday, February 18, 2005, Dan Schulman, Chief Executive Officer of Virgin Mobile USA, LLC ("Virgin Mobile"), Peter Lurie, General Counsel of Virgin Mobile, Antoinette C. Bush of Skadden, Arps, Slate, Meagher & Flom LLP, and John Beahn of Skadden Arps met with Commissioner Kathleen Abernathy and Senior Counsel Jennifer Manner to discuss Universal Service Fund ("USF") issues. The parties at this meeting discussed the USF issues described in the attached presentation.

Pursuant to Section 1.1206 of the Commission's rules, a copy of this letter, along with the materials distributed at the meeting, is being filed via ECFS with your office.

Should you have any questions, please do not hesitate to contact the undersigned.

Sincerely,

/s/ Antoinette C. Bush

Antoinette C. Bush
John M. Beahn

Counsel to Virgin Mobile USA, LLC

Attachment

cc: Jennifer Manner

Virgin mobile

Live without a plan.

Universal Service Reform and State Regulation of Wireless Services

Federal Communications Commission
February 17, 2005

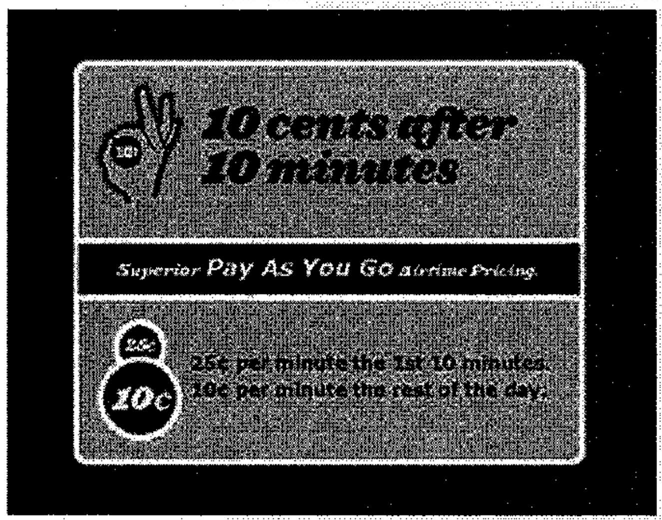
I. Introduction to Virgin Mobile USA (VMU)

- First Mobile Virtual Network Operator (MVNO) in the U.S.
  - Joint venture between Sprint and Sir Richard Branson's Virgin Group.
  - 3 million customers in just 2.5 years of operations.
  - Operates on Sprint's nationwide CDMA network.
  - Pay as you go: No long-term contracts.
  - Handsets available at 20,000 stores; Top-up cards available at 57,000 locations.
  - Focus on low-cost, affordable service to the following customers:
    - <u>Low-income</u>: A significant % of VMU customers have incomes below $35k.
    - <u>Without prior wireless service</u>: Many VMU customers are new to mobile services.
    - <u>Diverse</u>: A disproportionate amount of VMU customers are non-white (African-American, Latino, etc.).
    - <u>Youth market</u>: A majority of VMU's customers are 34 or younger.

- Virgin Mobile develops and maintains the entire customer experience.
  - Billing, customer care, handset graphic interface, and website.
  - Content and applications (VirginXtras and VirginXL): ringtones, games, comedy, entertainment information.

I. Introduction to VMU (cont'd)

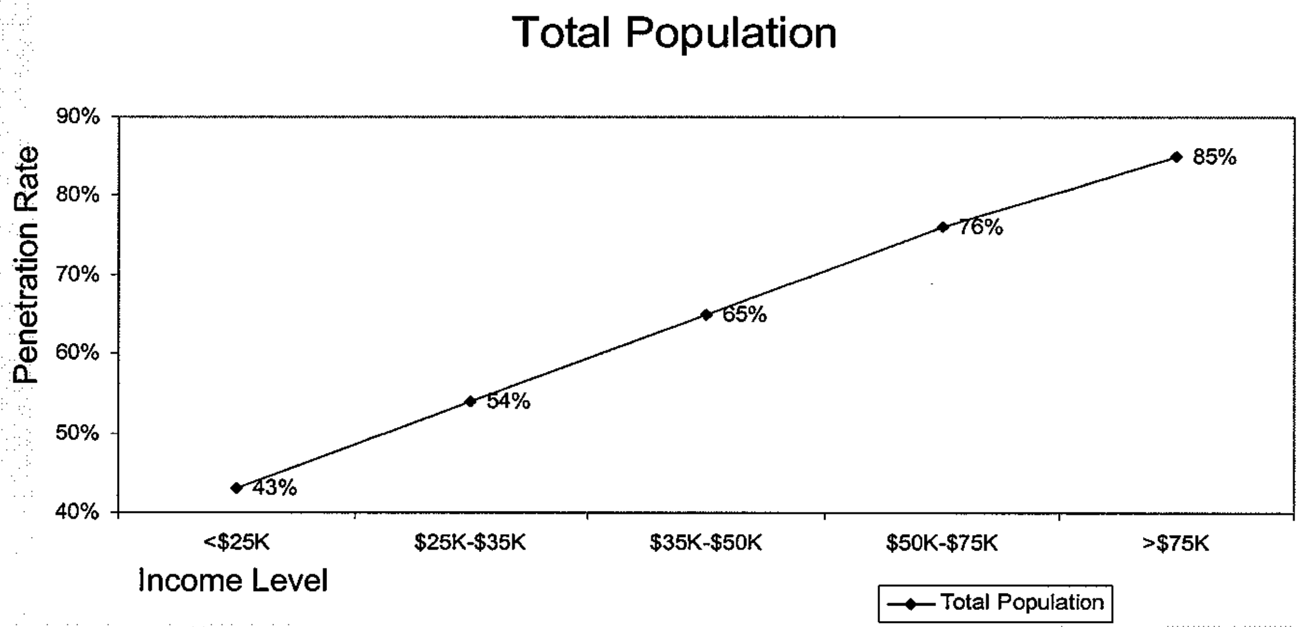
- Service Features/Value Proposition
  - Pay as you go (prepaid) service.
    - Customers only charged for minutes they want
  - No long-term contracts or monthly bills.
    - No credit checks
    - "Grab and go" product
  - All inclusive pricing (25-10-10).
    - No extra charges for regulatory fees, taxes, voicemail, or long distance.
    - **Postpaid carriers pass through all fees and benefit by having increased revenue growth rates.**



  - Flexible payment.
    - Prepaid cards purchased
    - Handset
    - Internet
    - Instant Top-Up
  - Innovative pricing benefits lower-usage, less-affluent customers.

II. Facts About the Prepaid Market

- Most wireless operators focus on high-income subscribers because subscription to wireless services is highly-dependant on income level:



- Many prepaid customers are lower-usage, lower-income consumers.
- Lower-income consumers receive advantages from prepaid service: Access to mobile services; Value for their money, and Access to emergency services on wireless devices.
- Prepaid services have expanded the availability of wireless services to customers not otherwise able to access wireless service.

III. Universal Service Fund (USF) Overview

- Virgin Mobile supports USF reform to decrease USF contribution obligations from all carriers while preserving the viability of the USF.
  - Expand USF contribution base.
  - Limit growth of High-Cost support mechanisms.
  - Eliminate USF waste and fraud.
- Virgin Mobile favors retention of existing revenue-based USF contribution methodologies.
  - Connection-based USF reform proposals would constitute a regressive regime disproportionately harming lower-income, prepaid customers.

III. USF Overview (cont'd)

- Contribution Base
  - The current pool of contributors cannot satisfy the increasing demands placed on the USF. Large classes of carriers are exempt from USF contribution obligations.
    - Eliminate exemption for VOIP (Wireline and Cable) services.
      - As VOIP usage grows, USF contribution base decreases accordingly, requiring increased contributions from existing contributors to cover shortfall.
      - VOIP revenue will increase while traditional telecommunications providers face a concomitant decline.
- High-Cost Support - subsidizes costs for rural carriers
  - The dramatic increase in High-Cost support payments (up 44% since 2000) is primarily responsible for the overall increase in USF contribution obligations.
  - Limiting the growth of High-Cost support payments is necessary to reduce overall USF contribution obligations.

III. USF Overview (cont'd)

- High-Cost Support (cont'd)
    - Level playing field for all carriers by adopting "forward-looking" cost methodologies. (Smaller carriers currently permitted to recover higher, "historic" costs).
    - Restrict Eligible Telecommunications Carriers (ETCs) to one per market.
- Waste and Fraud
  - The FCC must limit the waste associated with the USF.
    - Cap on High-Cost USF payments to individual carriers.
  - The FCC Inspector General's Sept. 30, 2004 report to Congress indicated that 36% of total USF/E-Rate disbursements were non-compliant with USF requirements.
    - Increase the resources dedicated to detecting and punishing USF fraud.

IV. Effect of USF Obligations on Lower-Income, Lower-Usage Customers

- Unlike local telecommunications services, demand for wireless services, especially prepaid services, is highly elastic: as prices go up, demand falls.
- Lower-income, prepaid customers are particularly sensitive to the adverse impact of higher USF contribution obligations.
    - Increased USF contribution rates might cause lower-income, prepaid customers to drop their wireless phone service altogether. (Many VMU customers are new to wireless.)
- Regulatory policies should spur increased wireless usage rates among lower-income consumers to drive overall wireless penetration higher.

V. Effect of USF Obligations on Virgin Mobile

- A shrinking contribution base, the explosive growth in High-Cost demand, and waste and fraud have caused USF contribution rates to increase dramatically.
- Increasing USF contribution obligations threaten innovative business models, especially prepaid wireless services.
  - Virgin Mobile does not pass-through regulatory fees and taxes to customers. As a result, Virgin Mobile must build regulatory fees and taxes into its cost structure.
  - In contrast, postpaid wireless carriers pass through USF fees.
    - The burden of increased USF contributions on postpaid carriers, therefore, is partially offset by the corresponding increase in revenue.
- USF obligations impair the range of pay as you go wireless service for the lower-income customers it was designed, in part, to benefit.

VI. Connection-Based Solutions Adversely Affect Prepaid Providers

- Lower-income, prepaid customers would pay a disproportionate amount to USF if $1/month/connection fee imposed.
    - Hypothetical postpaid subscriber with $58 ARPU.
        - $1 fee = 1.7% of monthly bill.
    - Hypothetical prepaid customer with $28 ARPU.
        - $1 fee = 3.6% of monthly bill.
  - Connection-based proposals would require lower-income, prepaid customers to pay into the USF - <u>even if they had no interstate usage in a given month</u>.
- Prepaid providers would have to pass through costs and fees to customers.
- A connection-based approach would be a regressive tax that would place a disproportionate burden on lower-income, prepaid customers, forcing them to subsidize higher-income, higher-volume users.

VII. Conclusions

- Fundamental reform is vital to achieving the pro-consumer and pro-competitive goals of the USF system.
- USF shortfalls should not be settled through increased contribution rates on existing contributors.
- The USF "crisis" arises from the failure to adequately assess USF contributions on all carriers, the increased demand for High-Cost support, and waste and fraud in the USF program.
- Reform should focus on the following actions:
  - Expand the base of contributors to increase USF revenue (problem only increases as VOIP usage grows):
    - Include VOIP (wireline and cable) providers.
  - Adopt policies that decrease demand on High-Cost support fund:
    - Level playing field by adopting forward-looking cost methodologies for all carriers.
    - Restrict competitive ETCs to one per market
  - Limit waste and fraud in the USF:
    - Cap on High-Cost payments.
    - Increase resources for fraud detection.

VIII. State Regulation of Wireless Services

- The Rise of State Regulation
  - Most state regulations, taxes, and fees directly conflict with Section 332's prohibitions on regulating the rates/entry of wireless providers.
  - According to CTIA, state governments introduced 1,541 pieces of legislation in 2003 to regulate the wireless industry:
    - State "consumer protection" requirements.
    - E911 fees.
    - Taxes - 19 states tax wireless services at double-digit rates.
  - State regulatory fees and taxes have the direct effect of raising wireless providers' rates, especially the rates of prepaid providers who cannot recover these costs from customers.
    - Lower-income customers bear a disproportionate burden of per-line, rather than usage-based state fees and taxes.
  - The trend toward increasing the amount and applicability of these "consumer protection" requirements, fees, and taxes (especially to prepaid wireless operators) threatens Congress' intentions for a deregulated wireless marketplace and greatly affects prepaid carriers' ability to offer services to lower-income customers.

IX. Preemption of State Regulation

- Federal Preemption is necessary to protect the wireless market from burdensome state regulation.
  - Federal preemption has been effective in eliminating state regulation and spurring the widespread deployment of other services (VOIP, broadband).
  - The FCC correctly preempted state regulation of VOIP and broadband services and should apply its preemption principles consistently for all telecommunications and information services providers - resulting in numerous benefits for the wireless marketplace:
    - Lower prices for all customers (including lower-income).
    - Continued expansion of wireless service to a broader range of customers.